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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1942.

No. 675

THE DETROIT EDISON COMPANY, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

PETITION FOR CERTIORARI FILED JANUARY 26, 1943.

CERTIORARI GRANTED MARCH 1, 1943.

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BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 103379

THE DETROIT EDISON COMPANY, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

APPEARANCES:

For Taxpayer: Edward H. Green, Esq., Harvey A. Fischer, Esq.

For Commissioner: Paul A. Sebastian, Esq.

DOCKET ENTRIES

1940

June 18—Petition received and filed. Taxpayer notified. (Fee paid).

June 13—Copy of petition served on General Counsel.

June 13—Request for circuit hearing in Detroit, Michigan, filed by taxpayer.

June 27—Notice of appearance of Harvey A. Fischer, as counsel for taxpayer, filed.

Aug. 9—Answer filed by General Counsel.

Aug. 13—Copy of answer served on taxpayer, Detroit, Mich.

1941

Feb. 19—Hearing set April 7, 1941, Detroit, Mich.

Apr. 14-16—Hearing had before Mr. Smith on the merits. Stipulation of facts to be received in Washington. Briefs due June 16, 1941; Reply briefs due July 5, 1941—Exchange.

Apr. 23—Stipulation of facts filed.

May 19—Transcript of hearing 4/14 & 16/41 filed.

[fol. 2] June 10—Brief filed by taxpayer.

June 16—Brief filed by General Counsel.

June 19—Copy of brief served on General Counsel.

July 3—Reply brief filed by taxpayer. 7/3/41 copy served on General Counsel.

Oct. 14—Opinion rendered, Smith, Div. 5. Decision will be entered for the respondent. 10/14/41 copy served.

Oct. 14—Decision entered, Arundell, Div. 7.

1942

Jan. 10—Supersedeas bond in the amount of $21,000.00 approved and ordered filed.

Jan. 10—Petition for review by United States Circuit Court of Appeals, Sixth Circuit, filed by taxpayer.

Jan. 10—Statement of points to be relied on filed by taxpayer.

Jan. 10—Præcipe for record filed by taxpayer.

Jan. 10—Designation of contents of record filed by taxpayer.

Jan. 13.—Proof of service of petition for review and statement of points filed.

Jan. 22—Counter designation of contents of record filed by General Counsel.

Jan. 30—Proof of service of counter-designation of contents of record filed by General Counsel.

BEFORE UNITED STATES BOARD OF TAX APPEALS

PETITION—Filed June 13, 1940

Now comes The Detroit Edison Company, a New York corporation, the Petitioner herein, and hereby files this, its Petition for the redetermination of the deficiency of $10,298.98 for the calendar years 1936 and 1937, (inclusive), as determined by the Commissioner of Internal Revenue in his Notice of Deficiency bearing date of April 26, 1940, and Bureau Symbols SN-IT-1, and as a basis for this proceeding, alleges as follows:

[fol. 3] First: That the Petitioner is a corporation, organized and existing under and by virtue of the laws of the State of New York, with its principal office for the transaction of its corporate business at 2000 Second Avenue, Detroit, Michigan.

Second: The Notice of Deficiency, a copy of which is annexed hereto, marked Exhibit "A", (by reference incorporated in and made a part of this Petition), was mailed to the Petitioner on or after April 26, 1940.

Third: The taxes in controversy, and covered in the deficiency letter, (Exhibit "A"), are income taxes for the calendar years 1936 and 1937 inclusive, the sum total of which is $10,298.98.

Fourth: In determining the foregoing deficiency, the Commissioner, (Respondent), committed the following errors:

(a) The Respondent erred in finding and ruling that the Petitioner's depreciation base for the calendar year 1936 should be decreased in the amount of $1,166,712.77.

(b) The Respondent erred in finding and ruling that the Petitioner was not entitled to the benefit of depreciation upon the sum of $1,166,712.77, for the calendar year 1936 in the sum of $40,273.11.

(c) The Respondent erred in finding and ruling that the Petitioner's depreciation base for the calendar year 1937 should be decreased in the amount of $1,208,496.01.

(d) The Respondent erred in finding and ruling that the Petitioner was not entitled to the benefit of depreciation upon the sum of $1,208,496.01 for the calendar year 1937 in the sum of $41,786.26.

Fifth: The facts upon which this Petitioner relies as the basis for this proceeding are as follows:

(a) The sum of $1,166,712.77 by which the Petitioner's depreciation base for the calendar year 1936 was erroneously decreased by the Respondent, represents cash expended by the Petitioner in the acquisition of tangible depreciable property used in its business.

(b) The sum of $1,208,496.01 by which the Petitioner's depreciation base for the calendar year 1937 was erroneously decreased by the Respondent, represents cash ex-
[fol. 4] pended by the Petitioner in the acquisition of tangible depreciable property used in its business.

(c) The Petitioner was entitled to a deduction for depreciation in the year 1936 on the said sum of $1,166,712.77; depreciation thereon at rates which have been approved by the Respondent, amounted to $40,273.11, and Respondent has erroneously reduced the depreciation claimed by the Petitioner for the year 1936 by that amount.

(d) The Petitioner was entitled to a deduction for depreciation in the year 1937 on the said sum of $1,208,496.01; depreciation thereon at rates which have been approved by the Respondent amounted to $41,786.26, and Respondent has erroneously reduced the depreciation claimed by the Petitioner for the year 1937 by that amount.

Wherefore, the Petitioner prays that this Board may hear the proceedings, and set aside the deficiency proposed by the Respondent, and correct the errors made by the Respondent, as herein complained of.

The Detroit Edison Company. By A. C. Marshall, President.

Edward H. Green, Attorney for Petitioner. Business Address: No. 48 Wall Street, New York, New York; Oscar C. Hull, Attorney for Petitioner. Business Address: 1101-14 Dime Building, Detroit, Michigan; Harvey A. Fischer, Attorney for Petitioner. Business Address: 1101-14 Dime Building, Detroit, Michigan.

(Duly verified).

[fol. 5] EXHIBIT "A" TO PETITION

Treasury Department

Internal Revenue Service

Detroit, Michigan

555 Federal Building
IT:CONF.

April 26, 1940.

The Detroit Edison Company,
2000 Second Avenue,
Detroit, Michigan.

Collection District: Michigan.

SIRS:

You are advised that the determination of your income tax liability for the taxable years 1936 and 1937 discloses a deficiency of $10,298.98 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a Petition, you are requested to execute the enclosed form and forward it to Internal

Revenue Agent in Charge, Detroit, Michigan, for the attention of IT: CONF. The signing and filing of this form will expedite the closing of your returns by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully, Guy T. Helvering, Commissioner, By Geo. E. Neal, Internal Revenue Agent in Charge.

Enclosures: Statement. Form of Waiver.

[fol. 6] Statement

IT:CONF.

The Detroit Edison Company
2000 Second Avenue
Detroit, Michigan.

Tax Liability for Taxable Years Ended December 31, 1936 and 1937

Income Tax

Years	Liability	Assessed	Deficiency
1936	$1,074,080.40	$1,070,049.36	$4,031.04
1937	1,330,487.12	1,324,219.18	6,267.94
	$2,404,567.52	$2,394,268.54	$10,298.98

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated April 15, 1938, January 5, 1939 and April 22, 1939; to your protest dated May 3, 1939 and to the statements made at conferences held on January 15, 1940, January 16, 1940, February 13, 1940 and February 14, 1940, March 6, 1940 and March 12, 1940.

A copy of this letter has been mailed to your representative, Mr. Harvey A. Fischer, 1104 Dime Bank Building, Detroit, Michigan, in accordance with authority contained in a power of attorney executed by you and on file in the Bureau.

1936

Adjustments to Net Income

Net income as disclosed by return		$7,178,479.31
Unallowable Deductions and Additional Income:		
(a) Contributions	$5,775.00	
(b) Bad debt recoveries	28,310.73	
[fol. 7]		
(c) Social Security taxes	1,462.78	
(d) Legal expense	933.00	
(e) Profit on sale of stock to employees	3,219.84	
(f) Fees	2,100.00	
(g) Excessive depreciation	40,273.11	
(h) Bad debts	115.55	
(i) Capital expenditures	1,431.55	
		83,621.56
Total		$7,262,100.87
Non-taxable Income and Additional Deductions:		
(j) Capital stock tax accrual	56,491.00	
(k) Amortization of bond discount, expenses	166.98	
		56,657.98
Net income as adjusted		$7,205,442.89

Explanation of Adjustments

(a) During the year 1936 you made contributions to the Committee of Public Utility Executives, in Washington, D. C. in the amount of $5775.00 and claimed such amount as a deduction under miscellaneous general expenses.

The above contributions are in the nature of donations not deductible as defined under Section 23 (q) of the Revenue Act of 1936.

(b) The following accounts with Municipalities were written off and claimed as a deduction from gross income for

1935, were recovered in part and balances reinstated during 1936.

[fol. 8] Livonia Township, collection		$503.20
Accounts reinstated—		
Livonia Township	$15,198.02	
Harrison Township	8,174.00	
Garden City	4,435.51	
		27,807.53
Total recovery		$28,310.73

Article 42-1 Regulation 94 relating to the Revenue Act of 1936 states—

"Bad debts or accounts charged off subsequent to March 1, 1913 because of the fact that they were determined to be worthless, which are subsequently recovered, whether or not by suit, constitute income for the year in which recovered, regardless of the date when the amounts were charged off."

Since the above accounts were charged off subsequent to March 1, 1913 because they were determined to be worthless, and they now have been collected or reinstated they constitute income for the year 1936.

(c) Social Security taxes accrued	$162,241.30
Social Security taxes accruable	$160,778.62
Excess Accrual	$1,462.68

(d) You claimed a deduction for legal expense in the amount of $933.00 incurred in connection with exchange of property between your corporation, Chrysler Corporation and the Detroit Terminal Railroad Company.

In accordance with Article 24-2 of Regulations 94, the cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense.

[fol. 9] (e) During the year 1936 you sold 1876 shares of your own capital stock to employees, under a stock purchase plan, for $160,327.62, the stock having been acquired by you in the open market at a cost of $157,107.78, thereby realizing a profit of $3219.84. See Exhibit "A" for details.

In accordance with G. C. M. 16651, published in Cumulative Internal Revenue Bulletin XV-2, July-December 1936, page 130, profits realized upon the sale of a company's own capital stock to its employees under a stock purchase plan, the stock having been acquired by the company in the open market, constitute taxable income.

(f) The deduction of $2100.00 for fee paid to the Securities and Exchange Commission for the registration of Series "G" bonds has been disallowed in accordance with IT 3026 published in Cumulative Internal Revenue Bulletin XV-2, July-December 1936, page 83, which states that the fee paid to the Securities and Exchange Commission for registration of securities is not deductible in computing net income inasmuch as the amount is a capital expenditure.

Since the fee paid applies to a specific series of bonds the amount is to be amortized over the life of such bonds. See Exhibit "B" attached.

(g) From time to time you receive applications for the extension of your transmission lines to places which, in your opinion, are too far removed from existing transmission lines to warrant capital expenditures necessary to serve such applicants. You will, however make the necessary capital expenditures required in the construction of a line extension upon the payment by the applicant for such services of a certain sum as fixed by you. It is then agreed in writing to thereafter extend service to the premises to be served by the line extension under the rules and regulations promulgated by the Michigan Public Service Commission.

In the past contributions were required from the applicants for electric service, ranging from $1500.00 per mile to $500 per mile, dependent upon a number of varying [fol. 10] factors. The amounts contributed by the applicant do not in all cases represent actual total cost of constructing the required line extension but rather in some cases only a part of said cost, the amount to be charged to the contributor being determined by you. In other cases the amount contributed by the consumer does represent the total cost of the extension line. The amount paid by the applicant in either case is final and no adjustment is made thereafter except in those cases where the contract provides that at the end of a calendar year during which the line shall have been built the company shall refund to the customer or his assignees an amount equal to one-half of the company's revenues from the said line from the time the

line was built to the end of the calendar year, and that at the end of each of the succeeding five calendar years the company shall similarly refund to the consumer or his assignee one-half of the revenues from said line for that year, provided that the aggregate amount of said refund shall not exceed such amount as may be mutually agreed upon and expressly stated in the contract. These contracts further provide that no refund shall be made on the basis of revenues derived from the said line after the expiration of the fifth calendar year following the calendar year in which the line is completed.

Upon the completion of any particular line extension you enter upon your books as a property item the full cost of the line extension including labor and material, and you do not subtract therefrom the amount of given contribution. Depreciation is taken upon your books and on the return, upon the basis of the full cost of the line extension without giving any effect to the amounts received as contributions from prospective users of electric current.

Depreciation has been disallowed for the years 1936 and 1937 in the respective amounts of $40,273.11 and $41,786.26. It is the position of the Government that to the extent of amounts received from your customers under certain contracts in aid of construction of extension lines [fol. 11] and for which the customer is entitled to no refund, and to the extent of the unrefunded balances forfeited by your customers under certain other contracts providing for refunds within a certain limited period of time, said amounts represent reimbursements of capital expenditures made to your corporation in the construction of said extension lines.

The unrefunded balances of aids in construction for the calendar years ended December 31, 1935 and December 31, 1936 have been determined in the respective amounts of $1,148,679.86 and $1,184,745.67, or an average reduction in your depreciable base for the calendar year 1936 in the amount of $1,166,712.77 on which depreciation has been disallowed as follows:

Average Depreciable Base	Rate	Depreciation Amount
$1,146,010.89	3.4604	$39,656.56
19,409.84	3.0104	584.31
1,292.04	2.4951	32.24
$1,166,712.77		$40,273.11

The unrefunded balances of aids in construction for the calendar years ended December 31, 1936 and December 31, 1937 have been determined in the respective amounts of $1,184,745.67 and $1,232,246.34, or an average reduction in your depreciable base for the calendar year 1937 in the amount of $1,208,496.01, on which depreciation has been disallowed as follows:

Average Depreciable Base	Rate	Depreciation Amount
$1,187,562.04	3 4661	$41,162.09
19,641,93	3.0137	591.95
1,292.04	2.4940	32.22
$1,208,496.01		$41,786.26

[fol. 12] In acquiring the net assets of Michigan Electric Power Company in 1935, deposits in closed banks were taken over at 31.45% of book value.

(h) Loss of deposit in Commercial Bank of Mayville in the amount of $367.40 is reduced by portion of discount applicable thereto. 31.45% of 267.40—$115.55.

(i) Cost of certain items of equipment purchased during the year 1936 was charged to expense as follows:

Kompak Air Filler	$1,006.96
Automatic Stoker	249.50
Unit Heater and Speed Controller	175.10
Total	$1,431.55

Section 24 of the Revenue Act of 1936 provides, in part, as follows:

(a) "General rule.—"In computing net income no deduction shall in any case be allowed in respect of—

(2) "Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;"

Inasmuch as the above items represent amounts paid out for permanent improvements they cannot be claimed as a deduction in computing net income. Hence your income has been increased in the amount of $1431.55.

(j) Capital stock tax deductible	$139,573.00
Capital stock deducted	83,082.00
Additional deduction	$56,491.00

The adjustment for the capital stock taxes for the year ended June 30, 1936 was made in connection with the audit of the return for the taxable year ended December [fol. 13] 31, 1935 as the deduction was properly accruable in the latter year.

(k) This adjustment is made to correct allowance for amortization of bond discount and expense as follows:

Expense amortized as per books:		
Series "C"	$ 2,838.06	
Series "D"	34,802.16	
Series "E"	33,704.64	
Amortized expense		$71,344.86
Net premium amortized as per books:		
Series "F"	20,314.89	
Series "G"	4,720.17	25,035.06
Amortized Income		$46,309.80
Allowable amortization, as corrected in Exhibit "B" attached		46,502.18
Difference		$ 192.38
Less: Difference between premium and redemption expense on series "C" bonds amortized per books	$14,116.96	
and amount allowance on return	14,091.56	25.40
Net adjustment		$ 166.98

Computation of Tax

Income Tax		
Net income for normal tax computation		$7,205,442.89
Less: Interest on U. S. Obligations	$20,192.98	
Dividends received credit	16,980.57	37,173.55
Normal tax net income		$7,168,269.34

[fol. 14]

8% of $2000.00 (Over 0 to $200)	160.00
11% of $13,000 (Over $200 to $15000)	1,430.00
13% of $25,000 (Over $15,000 to $40,0000)	3,250.00
15% of $7,128,269.34 (Over $40,000)	1,069,240.40
Total normal tax assessable	$1,074,080.40
Income tax assessed (normal tax and surtax) Original June list, Account No. 405608	1,070,049.36
Deficiency of income tax	$ 4,031.40

1937

Adjustments to Net Income

Net income as disclosed by return	$8,223,746.63
Unallowable Deductions and Additional Income:	
(a) Estimated final loss in closed bank	$381,876.10
(b) Federal capital stock tax accrual	15,010.48
(c) Loss due to abandonment of Delray Power House #2	140,294.04
(d) Cost of splicing cable at Delray Cable Plant	37,172.95
(e) Excess accrual for Federal Unemployment	2,063.56
(f) Loss claimed due to liquidation of subsidiary corporation	47,670.27
(g) Taxes paid for Delray Terminal Railway Company	1,534.56
(h) Depreciation on contributed properties	41,786.26
	667,408.22
Total	$8,891,154.85

[fol. 15] Non-taxable Income and Additional Deductions:	
(i) Depreciation on capital expenditures	143.16
(j) Adjustment to amortization of bond discount and expense	6,214.01
	6,357.17
Net income as adjusted	$8,884,797.68

1937

Explanation of Adjustments

Items (a), (b), (c), (d), (e), (f), (g), (i) and (j) have been agreed to.

(h). See item (g) for 1936.

Computation of Tax

Net income for normal tax computation	$8,884,797.68
Less:	
Dividends received credit	7,150.24
Normal tax net income	8,877,647.44
8% of $2000.00 (over 0 to $2000)	160.00
11% of 13000.00 (over $2000 to $15,000)	1,430.00
13% of 25000.00 (over $15,000 to $40,000)	3,250.00
15% of 8,837,647.44 (over $40,000)	1,325,647.12
Total normal tax assessable	$1,330,487.12
Income tax assessed (Normal tax and surtax):	
Original Sept. list, Account No. 405702-1	231,329.46
Additional April 12, 1940 list, Account No. 529003	92,889.72
	1,324,219.18
Deficiency of income tax	$ 6,267.94

[fol. 16] EXHIBIT "A"

Gross Profit on Shares of Reacquired Stock of the Detroit Edison Company Issued to Employees During the year 1936

	Shares	Amount
Option price to Employes of Reacquired Stock issued during the year 1936 (Exhibit N-1)	1,876	$160,327.62
Less: Cost to The Detroit Edison Company of Reacquired Stock which was issued to Employes during the year 1936	1,876	157,107.78
Gross Profit on shares of stock issued to Employes during the year 1936		$ 3,219.84

EXHIBIT "A-1" TO PETITION

Option Price of Reacquired Stock of the Detroit Edison Company Issued to Employes During Year 1936

	J.E.	Number of Shares	Option Price
January	108	162	$13,894.48
February	89	166	14,645.51
March	187	203	14,988.94
April	154	261	19,402.12
May	81	118	10,197.17
June	91	420	32,080.41
July	107	135	11,893.59
August	110	100	8,518.75
September	187	109	12,044.44
October	81	106	12,429.65
November	105	33	3,387.01
December	180	63	6,845.55
Total		1,876	$160,327.62

(Here follows 1 paster, Exhibit "B", folios 17-18)

[fol. 17-18]
The Detroit Edison Company
IT:Conf.

EXHIBIT "B" TO PETITION

Amortization of Bond Discount and Expense on General Refunding Mortgage Gold Bonds as Corrected

Series	Date of Issue	Date of Maturity	Amount of Issue	Unamortized Balances As Adjusted 12/31/35	Unamortized Balances Current Issue	Additions	Number of Months to Maturity	Allowable Amortization Per month	Allowable Amortization 1936	Unamortized Balances December 31, 1936 Redeemed	Unamortized Balances December 31, 1936 Remainder
C	8/1/26	8/1/62	$20,000,000 00	$100,593 54			319	$ 315 34	$ 2,838 06	$97,755 48	
D	2/1/31	2/1/61	50,000,000 00	872,954 97			301	2,900 18	34,802 16		$838,152 81
E	10/1/32	10/1/52	15,000,000 00	564,553 57			201	2,808 72	33,704 64		530,848 93
F	10/1/35	10/1/65	49,000,000 00	(634,126 84)		$37,997 67	357	(A)	(20,314 89)		(575,814 28)
E	"	"	—0—	5,029 24			357	14 0875	169 05		4,860 19
G	9/1/36	9/1/66	20,000,000 00	—0—	($546,778 03)		360	(B)	(4,720 17)		(542,057 86)
G	"	"	—0—	—0—		2,100 00	360	5,833			
								(C)	23 33		2,076 67
	TOTALS			$909,004 48	($546,778 03)	$40,097 67			$46,502 18	$97,755 48	$258,066 46

(a) Computed monthly on basis of new additions during year.
(b) Computed monthly over four month period.
(c) Period of four months.

[fol. 19] BEFORE UNITED STATES BOARD OF TAX APPEALS

ANSWER—Filed August 9, 1940

Comes now the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed herein, admits and denies as follows:

First, Second and Third. Admits the allegations contained in paragraphs, First, Second and Third of the petition.

Fourth (a) to (d), inclusive. Denies that the Commissioner erred as set forth in subparagraphs (a) to (d), inclusive, of paragraph Fourth of the petition.

Fifth (a) to (d), inclusive. Denies the allegations of fact contained in subparagraphs (a) to (d), inclusive, of paragraph Fifth of the petition.

Sixth. Denies generally and specifically each and every allegation contained in the petition not hereinbefore specifically admitted, qualified or denied.

Wherefore, it is prayed that the Commissioner's determination be approved.

(Signed) J. P. Wenchel, P.M.C., Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

DeWitt M. Evans, Division Counsel; Paul A. Sebastian, Special Attorney, Bureau of Internal Revenue.

PAS/CH/8/5/40

BEFORE UNITED STATES BOARD OF TAX APPEALS

STIPULATION OF FACTS—Filed April 23, 1941

The parties hereto, through their respective attorneys of record, hereby stipulate that the following facts are true and may be received in evidence without further proof thereof, each party, however, reserving the right to object [fol. 20] to the admissibility of any of the facts so stipulated on the ground of materiality or relevancy, and each party further reserving the right to introduce other evidence not inconsistent with the facts herein stipulated.

(1) The Petitioner is a corporation organized and existing under and by virtue of the laws of the State of New York, but duly admitted and licensed to do business in the State of Michigan.

(2) The Petitioner is a Public Utility Corporation engaged among other things, in the generation and sale of electric energy in the City of Detroit, Michigan, and surrounding territory, (but entirely within the State of Michigan), and operates under the jurisdiction of the Michigan Public Service Commission.

(3) The Petitioner in connection with the distribution and sale of electric energy, from time to time receives applications for the extension of its transmission and/or distribution lines to places which in the opinion of the Petitioner are situated too far from existing transmission and/or distribution lines to warrant the expenditure of amounts necessary to serve such applicants for service.

(4) Upon payment by the applicant of a sum fixed by the Petitioner, the latter agrees in writing to make the necessary expenditures required in the construction of a line extension. The agreement between the Petitioner and each applicant is evidenced by one of five types of agreements which are annexed hereto and marked Exhibits 1, 2, 3, 4 and 5.

(5) The Petitioner has from time to time required the applicant to pay varying sums ranging from $500.00 per mile to $1,500.00 per mile of line extension. These amounts as fixed by the contracts represent the estimated cost per mile of line construction.

(6) The amount of the payment made by the applicant is the estimated cost, and not the actual cost, but it never exceeds the actual cost of constructing the requested line extension, and no increase or decrease is made in the amount fixed in the contract upon the completion of the line [fol. 21] extension by reason of the actual cost thereof. The amount paid by the applicant is in all cases final as to such applicant. The applicant may however, in accordance with the Agreement in writing, providing for refunds, become entitled to receive all or part of such payment upon the happening of the events provided for therein.

(7) The material and property used in the construction of the line extension and the cost of labor, is in all cases paid from the general working funds of the Petitioner. The records of the Petitioner set forth and identify all work performed and to be performed under the provisions of any given contract.

(8) Upon the completion of the line extension, the Petitioner in accordance with standard practice enters upon its books as a "property item", (such as poles, lines etc.) the cost of the line extension, including labor and material, and does not substract from that sum the amount of the payment made by the applicant.

(9) Depreciation is claimed by the Petitioner for income tax purposes for the years 1936-1937 upon the cost to the Petitioner thus arrived at, at rates approved by the Commissioner.

(10) The cash payment made by the applicant in those contracts providing for refunds, is not earmarked for the building of any given line extension, but upon its receipt becomes a part of the free working capital of the Petitioner. The cash account is debited for the full amount of the payment, and a like amount is credited to a liability account entitled, "Customers' Deposits for Line Extensions", classified under Account No. 261, "Miscellaneous Unadjusted Credits" as required by the Uniform Classification of Accounts for Electric Utilities prescribed by the Michigan Public Utilities Commission, (now known as Michigan Public Service Commission). After the expiration of the period during which refunds may be made to the customers under the terms of the written contract pursuant to which a line extension has been constructed, the Petitioner is [fol. 22] then required by Account No. 255 to transfer the unrefunded balance, if any, from Account No. 261 "Miscellaneous Unadjusted Credits" to Account No. 255, which reads as follows:

"255. Contributions for Extensions

To this account shall be credited contributions in money or property made to the accounting company for the purpose of assuming the burden of any part of the burden represented by the investment necessary for the establishment or extension of services rendered by the company. This covers such items as contributions toward the cost of line extensions in sparsely settled territory made by consumers, either voluntarily or when reasonably required by the company as a condition of giving the desired service, and the cost of services to which the company has title, in so far as such cost is borne by the consumer; it also covers grants from municipal or other governmental bodies or contribu-

tions from chambers of commerce and similar organizations made with the object of establishing a new service in the community by assuming part of the investment cost of the enterprise.

Note.—This does not include advances for the construction of extensions which are ultimately to be repaid wholly or in part to the consumer; such advances should be credited to account No. 261, "Miscellaneous Unadjusted Credits". When final determination has been made as to the amount of the advances to be returned to the consumer, the balance, if any, shall be credited to this account."

Account No. 261 provides as follows:

"261. Miscellaneous Unadjusted Credits

This account shall include the amount of credit balances in suspense accounts that can not be entirely cleared and disposed of until additional information is received."

[fol. 23] With respect to those contracts which do not provide for refunds, the cash payments are debited to cash and credited to an account designated "255—Contributions for Extensions" as required by the Uniform Classification of Accounts for Electric Utilities prescribed by Michigan Public Utilities Commission.

(11) The Petitioner under the terms of certain of the Agreements (Exhibits 1-4 inclusive), relating to the construction of a line extension is under a legal liability upon the happening of certain conditions during the first five calendar years following the construction of the requested extension to refund to the applicant for service the full amount of the applicant's payment. The amount of the refund and the time for the making thereof is in some cases determined by the number of additional customers who subscribed to the service subsequent to the building of the extension, while in others, the revenue derived by the Petitioner from the line extension is the measure of the customer's refund. After the expiration of five calendar years following the building of the line extension, the liability of the Petitioner to refund any part of the payment ceases.

Under some of the contracts, (Ex. 5) the applicant is not entitled to receive refunds.

The following tabulation represents unrefunded balances of payments made by applicants for line extension under

the provisions of Exhibits 1-5 inclusive at the date given, and which were then not subject to further refunds.

	12-31-35	12-31-36	12-31-37
Unrefunded balance of payments made under line extension agreements providing for refunds to customers:			
Regular O. H. Line (See Exhibits I & II)	$452,020.56	$461,447.54	$465,363.42
Farm O. H. Line (See Exhibits III & IV)	441,791.91	464,571.68	486,084.66
Gas Extension (No Standard form)	834.27	834.27	834.27
Total	$894,646.74	926,853.49	952,282.35
[fol. 24]			
Payments made by applicants for line extensions under the terms of a contract and under which the applicant is not entitled to receive any refund (See Exhibit V)	2,005.00	2,005.00	10,225.44
Miscellaneous line extension agreements covered by various types of contract but with respect to which the applicant is not entitled to receive any refund (no agreement forms)	$252,028.12	255,887.18	269,738.55
Totals	$254,033.12	257,892.18	279,963.99
Grand Totals	$1,148,679.86	$1,184,746.67	$1,232,246.34

(12) Unrefunded balances not subject to further refunds (under the provisions of Exhibits 1-4 inclusive), and the balance of payments made and not refundable (under the Provisions of Exhibits 5) were transferred to surplus by the Petitioner in the years and amounts set opposite thereto as follows:

November 30, 1932	$992,802.07
December 31, 1933	54,396.53
December 31, 1934	45,963.87

The foregoing sums represent the total balances of Account 255—"Contributions for Extensions" as of the date the respective transfers were made.

(13) As of December 31, 1935, the total amount paid by such applicants, less any refunds made in accordance with any of the five types of agreements, (Exhibits 1-5), was $1,148,679.86. Said amount representing unrefunded deposit balances with respect to which the five year period

within which refunds might have been made under the terms of the contract, had expired, and amounts paid under contracts which do not provide for a refund.

As of December 31, 1936, the total amount paid by such applicants, less any refunds made in accordance with any of the five types of agreements, (Exhibits 1-5), was $1,184,745.67. Said amount representing unrefunded deposit [fol. 25] balances with respect to which the five year period within which refunds might have been made under the terms of the contract had expired, and amounts paid under contracts which do not provide for a refund.

As of December 31, 1937, the total amount paid by such applicants, less any refunds, made in accordance with any of the five types of agreements, (Exhibits 1-5), was $1,232,246.34. Said amount representing unrefunded deposit balances with respect to which the five year period within which refunds might have been made under the terms of the contract, had expired, and amounts paid under contracts which do not provide for a refund.

(14) The Petitioner following the building of the line extension is obligated to thereafter keep and maintain the line thus constructed, including replacement in whole or in part as and when necessary, so that service will thereafter be available to the customer or customers.

(15) During the years 1936 and 1937, the Petitioner did not report as taxable income the sums of $36,065.81 and $47,500.67. These sums represent the balance of unrefunded payments made by applicants for line extensions, and with respect to which the five year period during which refunds might have become due to such applicants, expired during each of said years. The applicants were thereafter no longer entitled to receive refunds with respect to such unrefunded balances. The Respondent did not subject said sums to Federal Income Tax.

(16) The Commissioner claims that the amount recoverable through depreciation is the original cost of construction of the line extension as shown by the Petitioner's books, diminished by the total amount paid by customers under certain agreements providing for no refund to customers, and also diminished by the unrefunded balances of amounts paid by customers under other agreements providing for refunds to such customers, and with respect to which the

five year period within which refunds might have been [fol. 26] made, had expired. The Petitioner claims that the amount recoverable through depreciation is the original cost of construction of line extensions as shown by the Petitioner's books, without any deduction for the amounts paid by the customers.

The following tabulation represents the unrefunded balances of amounts paid by applicants for line extensions in prior years, and which the Petitioner claims should be included in the depreciable base. It also represents the rate of depreciation and the amount of depreciation for the calendar years 1936 and 1937.

Year	Average Depreciable Base Disallowed	Rate	Amount of Depreciation Disallowed
1936	$1,146,010.89	3.4604	$39,656.56
	19,409.84	3.0104	584.31
	1,292.04	2.4951	32.24
	$1,166,712.77		$40,273.11
1937	$1,187,562.04	3.4661	$41,162.09
	19,641.93	3.0137	591.95
	1,292.04	2.4940	32.22
	$1,208,496.01	—	$41,786.26

(Signed) J. P. Wenchel, P.M.C., Attorney for Commissioner. The Detroit Edison Company, by A. C. Marshall, President.

(Signed) Edward H. Green, Oscar C. Hull, Harvey A. Fischer, Attorneys for Petitioner.

[fol. 27] EXHIBIT I TO STIPULATION OF FACTS

Agreement for Line Extensions

Memorandum of Agreement, Made this — day of —— Nineteen Hundred ——, by and between The Detroit Edison Company, a corporation operating under the laws of the State of Michigan, hereinafter called the Company, and —— —— of ——, —— County, Michigan, hereinafter called the Customer.

Whereas, the said Customer has applied to the said Company for its electrical service at ——, —— County, Michigan; and, Whereas, the Company does not consider war-

ranted at the present time the investment in poles, wires, etc., necessary to extend its lines to the places where the said service is desired;

Therefore it is Agreed between the parties hereto, as follows:

First: The Company shall build the necessary line extension from —— —— to —— —— in accordance with its standard construction, said line to be and remain the property of the Company and become part of its system.

Second: The Customer shall pay to the Company the sum of (1) —— dollars for the building of the said line, said amount to be paid at the time of signing of this agreement.

Third: At the end of the calendar year during which the said line shall have been built the Company shall refund to the Customer, or his assignee, an amount equal to one-half of the Company's revenues from the said line from the time the line was built to the end of the calendar year. At the end of each of the succeeding five calendar years the Company shall similarly refund to the Customer, or his [fol. 28] assignee, one-half of the revenues from the said line for that year; provided that the aggregate amount of the said refunds shall not exceed (1) —— dollars, and that no refund shall be made on the basis of revenues derived from the said line after the expiration of the fifth calendar year following the calendar year in which the said line is completed.

In execution whereof the parties hereto have set their hands the day and year first above written.

The Detroit Edison Company by —— ——, Special Agent. —— ——, (Customer).

Instructions

1. The amount to be written into the spaces in the Second clause and the Third clause of this agreement is the estimated cost of the building of the line extension, at the prices for material and labor prevailing at the time of the construction, plus 10% additional to cover all overhead costs.

2. For definition of *Line Extensions*, as distinguished from *Service Connections*, see extracts from the Company's

rule concerning *Line Extensions and Service Connections*, as filed with the Michigan Public Utilities Commission, reprinted on the back hereof.

3. In case the Customer elects to build the Line Extension (See Section 5 of the Company's rule concerning Line Extensions and Service Connections, reprinted on the back hereof), proper rider is to be attached to this agreement, amending the First and Second clauses thereof to this effect, and specifying the amount to be written into the space in the Third clause of the agreement.

4. Copy of this agreement is to be given to the Customer.

[fol. 29] EXHIBIT I (Reverse)

Extracts from the Company's Rule Concerning Line Extensions and Service Connections

(Reprinted from rule 5 filed with Michigan Public Utilities Commission.)

2. The Company reserves to itself the right to decide (subject to appeal to the Michigan Public Utilities Commission) whether or not any proposed or requested extension of lines shall or shall not be made.

4. *A Line Extension* (for the purposes of this Rule) is defined as the wires, insulators, insulator supports, cross arms, poles, braces, guys and guy stubs, set up or to be set up on a public highway ready for the delivery of electric supply to the applicant in question; and is measured from the point of connection to a previously existing low tension line of the Company, to the point where the Service Connection (See Section 6) is made or to be made to serve the applicant, or the furthest such Service Connection, if there be more than one applicant; including an overhead ground wire, if any be used, and special construction required for a railroad crossing or crossings or on account of unusual physical obstacles; but not including line switches, fuses, lightning arresters and transformers, notwithstanding that they may be necessary.

5. Where a proposed line extension will require an expenditure out of proportion to the revenue obtainable therefrom, the proposed extension may be made (subject to the

reservation of Section 2 hereof) under the terms of the Agreement for Line Extensions, as hereinafter specified. This applies particularly to extensions in subdivisions platted but not adequately built up (or building up) with permanent residences, and to rural extensions.

In such cases the applicant for service may build the line extension for the same at his cost, according to the Company's specifications; or may employ the Company to build the same at his cost, payable in advance; and in either such case the Company will refund to the applicant, or his assignee, one-half of the revenues from the said line extension from the time it was built to the end of the fifth succeeding calendar year; provided that the amount refunded shall not exceed the cost of the said line extension; all as set forth in the Agreement for Line Extension filed herewith and made part of this Rule, • • • • •

Service Connections

6. The Company will make, at its own expense, overhead service connections for low tension service requiring only a single span swung from the premises to a pole line on the abutting highway; or, alternatively, low tension underground service connections not greater in length than the width of the highway plus the necessary length within the customer's premises to pass through his basement wall to the service switch at the entrance point. The provisions of this section do not apply to service connections for primary (high tension) current for which see Section 8.

7. The Company will, as heretofore, furnish line wire and insulators for overhead service connections greater than [fol. 30] one span in length, and being, except the entering span, entirely on the premises of the customer, or upon a private right of way provided by him, in accordance with, and upon signature of, the *Agreement for Service Extension on Private Property*, filed herewith and made part of this Rule, • • • • •

The provisions of this Section do not apply to service connections for primary (high tension) current, for which see Section 8.

8. Service Connections for the delivery of primary (high tension) current, nominal 4400 volts, will, as heretofore, be

made entirely at the expense of the customer. Within the corporate limits of any city or village such service connections will be made underground, this construction being usually required for public safety.

EXHIBIT II TO STIPULATION OF FACTS

Agreement for Line Extension - Regular D E Co Form SA 145

Memorandum of Agreement, Made this ..... day of ..... Nineteen Hundred ..... by and between The Detroit Edison Company, a corporation operating under the laws of the State of Michigan, hereinafter called the Company, and ..... of ..... County, Michigan, hereinafter called the Customer.

Whereas, the said Customer has applied to the said Company for its electrical service at ..... County, Michigan; and,

Whereas, the Company does not consider warranted at the present time the investment in poles, wires, etc., necessary to extend its lines to the place where the said service is desired;

Therefore it is Agreed between the parties hereto, as follows:

First: The Company shall build the necessary line extension from ..... to ..... in accordance with its standard construction, said line to be [fol. 31] and remain the property of the Company and become part of its system.

Second: The Customer shall pay to the Company the sum of (1) ..... dollars for the building of the said line, said amount to be paid at the time of signing of this agreement.

Third: At the end of the calendar year during which the said line shall have been built the Company shall refund to the Customer, or his assignee, an amount equal to one-half of the Company's revenues from the said line from the time the line was built to the end of the calendar year. At the end of each of the succeeding five calendar years the Com-

pany shall similarly refund to the Customer, or his assignee, one-half of the revenues from the said line for that year; provided that the aggregate amount of the said refunds shall not exceed (1) dollars, and that no refund shall be made on the basis of revenues derived from the said line after the expiration of the fifth calendar year following the calendar year in which the said line is completed.

In execution whereof the parties hereto have set their hands the day and year first above written.

The Detroit Edison Company. By —— ——, Special Agent; —— ——, (Customer).

Instructions

1. The amount to be written into the spaces in the Second clause and the Third clause of this agreement is the estimated cost of the building of the line extension, at the prices for material and labor prevailing at the time of the construction, plus 10% additional to cover all overhead costs.

[fol. 32] 2. For definition of *Line Extensions*, as distinguished from *Service Connections*, see extracts from the Company's rule concerning *Line Extensions and Service Connections*, as filed with the Michigan Public Utilities Commission, reprinted on the back hereof.

3. In case the Customer elects to build the Line Extension (See Section 5 of the Company's rule concerning Line Extensions and Service Connections, reprinted on the back hereof), proper rider is to be attached to this agreement, amending the First and Second clauses thereof to this effect, and specifying the amount to be written into the space in the Third clause of the agreement.

4. Copy of this agreement is to be given to the Customer.

Exhibit II (Reverse)

Extracts from the Company's Rule Concerning Line Extensions and Service Connections

(Reprinted from rule 5 filed with Michigan Public Utilities Commission)

2. The Company reserves to itself the right to decide (subject to appeal to the Michigan Public Utilities Com-

mission) whether or not any proposed or requested extension of lines shall or shall not be made.

4. *A Line Extension* (for the purposes of this Rule) is defined as the wires, insulators, insulator supports, cross arms, poles, braces, guys and guy stubs, set up or to be set up on a public highway ready for the delivery of electric supply to the applicant in question; and is measured from the point of connection to a previously existing low tension line of the Company, to the point where the Service Connection (See Section 7) is made or to be made to serve the applicant, or the furthest such Service Connection, if there be more than one applicant; including an overhead ground wire, if any be used, and special construction required for a railroad crossing or crossings or on account of unusual physical obstacles; but not including line switches, fuses, lightning arresters and transformers, notwithstanding that they may be necessary.

5. Where a proposed line extension will require an expenditure out of proportion to the revenue obtainable therefrom, the proposed extension may be made (subject to the reservation of Section 2 hereof) under the terms of the Agreements for Line Extensions, as hereinafter specified. The regular form of agreement applies particularly to extensions in subdivisions platted but not adequately built up (or building up) with permanent residences, and to rural extensions. The optional form of agreement applies only to farm extensions.

Under the Regular Agreement the applicant for service may build the line extension for the same at his cost, according to the Company's specifications; or may employ the Company to build the same at his cost, payable in advance; and in either such case the Company will refund to the applicant, or his assignee, one-half of the revenues from the said line extension from the time it was built to the end of [fol. 33] the fifth succeeding calendar year; provided that the amount refunded shall not exceed the cost of the said line extensions; all as set forth in the Regular Agreement for Line Extension filed herewith and made part of this Rule.

Service Connections

7. The Company will make, at its own expense, overhead service connections for low tension service requiring only a

single span swung from the premises to a pole line on the abutting highway; or, alternatively, low tension underground service connections not greater in length than the width of the highway plus the necessary length within the customer's premises to pass through his basement wall to the service switch at the entrance point. The provisions of this section do not apply to service connections for primary (high tension) current, for which see Section 10.

8. The Company will, as heretofore, furnish line wire and insulators for overhead service connections greater than one span in length, and being, except the entering span, entirely on the premises of the customer, or upon a private right of way provided by him, in accordance with, and upon the signature of, the *Agreement for Service Connection on Private Property*, filed herewith and made part of this Rule.

* * * * * * *

10. Service Connections for the delivery of primary (high tension) current, nominal 4400 volts, will as heretofore, be made entirely at the expense of the customer. Within the corporate limits of any city or village such service connections will be made underground, this construction being usually required for public safety.

EXHIBIT III TO STIPULATION OF FACTS

Agreement For Line Extensions (Optional for Farm Lines)

Memorandum of Agreement, Made this day of Nineteen Hundred by and between The Detroit Edison Company, a corporation operating under the laws of the State of Michigan, hereinafter called the Company, and of County, Michigan, hereinafter called the Customer.

Whereas, the said Customer, for himself and associates, has applied to the said Company for its electric service at

[fol. 34] County, Michigan; and, Whereas, the Company does not consider warranted at the present time the investment in poles, wires, etc., necessary to extend its lines to the place where the said service is desired;

Therefore it is Agreed between the parties hereto, as follows:

First: The Company shall build the necessary line extension from .....

to .....
in accordance with its standard construction, said line to be and remain the property of the Company and become part of its system.

Second: The Customer shall pay to the Company the sum of (1) ..... dollars as a contribution toward the building of the said line, said amount to be paid at the time of signing of this agreement.

In execution whereof the parties hereto have set their hands the day and year first above written.

The Detroit Edison Company. By —— ——, Special A nt. —— ——, (Customer).

Instructions

1. The amount to be written into the space in the Second clause of this agreement is the estimated cost of the building of the line extension, at the rate of $1,500.00 per mile of extension (fractions of miles at proportionate rate) less allowance of $100.00 per customer agreeing to take the service at the time of building the line.

2. For definition of *Line Extensions*, as distinguished from *Service Connections*, see extracts from the Company's rule concerning *Line Extensions and Service Connections*, as filed with the Michigan Public Utilities Commission, reprinted on the back hereof.

3. Copy of this agreement is to be given to the Customer.

[fol. 35] Exhibit III (Reverse)

Extracts from the Company's Rule Concerning Line Extensions and Service Connections

(Reprinted from rule 5 filed with Michigan Public Utilities Commission)

2. The Company reserves to itself the right to decide (subject to appeal to the Michigan Public Utilities Com-

mission) whether or not any proposed or requested extension of lines shall or shall not be made.

4. *A Line Extension* (for the purposes of this Rule) is defined as the wires, insulators, insulator supports, cross arms, poles, braces, guys and guy stubs, set up or to be set up on a public highway ready for the delivery of electric supply to the applicant in question; and is measured from the point of connection to a previously existing low tension line of the Company, to the point where the Service Connection (See Section 7) is made or to be made to serve the applicant, or the furthest such Service Connection, if there be more than one applicant; including an overhead ground wire, if any be used, and special construction required for a railroad crossing or crossings or on account of unusual physical obstacles; but not including line switches, fuses, lightning arresters and transformers, nothwithstanding that they may be necessary.

5. Where a proposed line extension will require an expenditure out of proportion to the revenue obtainable therefrom, the proposed extension may be made (subject to the reservation of Section 2 hereof) under the terms of the Agreements for Line Extensions, as hereinafter specified. The regular form of agreement applies particularly to extensions in subdivisions platted but not adequately built up (or building up) with permanent residences, and to rural extensions. The optional form of agreement applies only to farm extensions.

* * * * * * *

6. Farm Line Extensions may, at the option of the proposed customers, be built under the following optional form of agreement, which provides that the customers shall contribute $1,500.00 per mile of line, less $100.00 per customer connected at the time the line is built.

Service Connections

7. The Company will make, at its own expense, overhead service connections for low tension service requiring only a single span swung from the premises to a pole line on the abutting highway; or, alternatively, low tension underground service connections not greater in length than the width of the highway plus the necessary length within the customer's premises to pass through his basement wall to

the service switch at the entrance point. The provisions of this section do not apply to service connections for primary (high tension) current for which see Section 9.

8. The Company will, as heretofore, furnish line wire and insulators for overhead service connections greater than one span in length and being, except the entering span, [fol. 36] entirely on the premises of the customer, or upon a private right of way provided by him, in accordance with, and upon signature of, the *Agreement for Service Extension on Private Property*, filed herewith and made part of this Rule, * * *

The provisions of this Section do not apply to service connections for primary (high tension) current, for which see Section 9.

9. Service Connections for the delivery of primary (high tension) current, nominal 4400 volts, will, as heretofore, be made entirely at the expense of the customer. Within the corporate limits of any city or village such service connections will be made underground, this construction being usually required for public safety.

EXHIBIT IV TO STIPULATION OF FACTS

Agreement For Line Extensions

(Optional for farm lines)

D. E. Co. Form S.A. 131

Memorandum of Agreement, Made this — day of — Nineteen Hundred — by and between The Detroit Edison Company, a corporation operating under the laws of the State of Michigan, hereinafter called the Company, and — of —, — County, Michigan, hereinafter called the Customer.

Whereas, the said Customer, for himself and — associates, has applied to the said Company for its electric service at —, — County, Michigan; and, Whereas, the Company does not consider warranted at the present time the investment in poles, wires, etc., necessary to extend its lines to the place where the said service is desired;

Therefore it is Agreed between the parties hereto, as follows:

First: The Company shall build the necessary line extension from —— to —— in accordance with its standard [fol. 37] construction, said line to be and remain the property of the Company and become part of its system. The Customer shall secure the necessary right of way for poles and lines to be set off the highway on private property, and where necessary, back of trees.

Second: The Customer shall pay to the Company the sum of (1) — dollars as a contribution toward the building of the said line, said amount to be paid at the time of signing of this agreement.

Third: The Company further agrees that a refund of $60.00 shall be given the Customer for each additional customer connected to the original extension after it has been completed; provided, however, that no refund shall be made made after the close of the fifth calendar year following that year during which the extension was built, nor shall the total refunds exceed (1) — dollars.

In execution whereof the parties hereto have set their hands the day and year first above written.

The Detroit Edison Company, By —— ——, Special Agent. —— ——(customer).

Instructions

1. The amount to be written into the space in the Second and Third clauses of this agreement is the estimated cost of the building of the line extension, at the rate of $1,000.00 per mile of extension (Fractions of miles at proportionate rate) less allowance of $100.00 per Farm Customer agreeing to take the service at the time of building the line.

2. For definition of Line Extensions, as distinguished from Service Connections, and for definition of Additional Customer see extracts from the Company's rule concerning Line Extensions and Service Connections, as filed with the Michigan Public Utilities Commission, reprinted on the back hereof.

3. Copy of this agreement is to be given to the Customer.

[fol. 38] EXHIBIT IV (Reverse)

Extracts From the Company's Rule Concerning Line Extensions and Service Connections

(Reprinted from Rule 5 Filed With Michigan Public Utilities Commission.)

2. The Company reserves to itself the right to decide (subject to appeal to the Michigan Public Utilities Commission) whether or not any proposed or requested extension of lines shall or shall not be made.

4. *A Line Extension* (for the purposes of this Rule) is defined as the wires, insulators, insulator supports, cross arms, poles, braces, guys and guy stubs, set up or to be set up on a public highway ready for the delivery of electric supply to the applicant in question; and is measured from the point of connection to a previously existing low tension line of the Company, to the point where the Service Connection (See Section 7) is made or to be made to serve the applicant, or the furthest such Service Connection, if there be more than one applicant; including an overhead ground wire, if any be used, and special construction required for a railroad crossing or crossings or on account of unusual physical obstacles; but not including line switches, fuses, lightning arresters and transformers, notwithstanding that they may be necessary.

5. Where a proposed line extension will require an expenditure out of proportion to the revenue obtainable therefrom, the proposed extension may be made (subject to the reservation of Section 2 hereof) under the terms of the Agreements for Line Extensions, as hereinafter specified. The regular form of agreement applies particularly to extensions in subdivisions platted but not adequately built up (or building up) with permanent residences, and to rural extensions. The optional form of agreement applies only to farm extensions.

. . . . . .

6. Form Line Extensions may, at the option of the proposed customers, be built under the following optional form of agreement, which provides that the customers shall contribute $1,000.00 per mile of line, less $100.00 per farm customer connected at the time the line is built, and that the

Customer shall secure right of way for poles and lines to be set off the highway on private property, and where necessary, back of trees.

Additional Customers are defined as customers not in the group originally dealt with and who are connected to the original extension after it has been completed. When an additional customer has been connected to the extension and when he begins to take service therefrom, there will be refunded to the signer of the agreement for the original extension the sum of $60.00 for each such additional customer. No refunds for additional customers will be made after the close of the fifth calendar year following that year during which the extension was built, and when refunds reach a sum equal to the amount actually paid by the original signer, all refunding shall cease.

[fol. 39] Service Connections

7. The Company will make at its own expense, overhead service connections for low tension service requiring only a single span swung from the premises to a pole line on the abutting highway; or, alternatively, low tension underground service connections not greater in length than the width of the highway plus the necessary length within the customer's premises to pass through his basement wall to the service switch at the entrance point. The provisions of this section do not apply to service connections for primary (high tension) current, for which see Section 10.

8. The Company will, as heretofore, furnish line wire and insulators for overhead service connections greater than one span in length, and being, except the entering span, entirely on the premises of the customer, or upon a private right of way provided by him, in accordance with, and upon the signature of, the *Agreement for Service Connection on Private Property*, filed herewith and made part of this Rule. * * *

10. Service Connections for the delivery of primary (high tension) current, nominal 4400 volts, will as heretofore, be made entirely at the expense of the customer. Within the corporate limits of any city or village such service connections will be made underground, this construction being usually required for public safety.

Exhibit V to Stipulation of Facts

Private Property Service Connection Agreement

D E CO FORM SA 23

Memorandum of Agreement Made and entered into this — day of ——, 19—, by and between The Detroit Edison Company, a corporation operating under laws of the State of Michigan, hereinafter called the Company, and ——— ——— of ——— —— County, Michigan, hereinafter called the Customer.

Whereas, the said Customer has applied to the said Company for its electric service at ——— ——— County, Michigan, and Whereas, there is no highway or public place by which the Company can extend its lines to the location where said service is desired.

[fol. 40] Therefore it is Agreed between the parties hereto, as follows:

(1) The Customer shall provide a feasible and reasonable route for extending the service connection from the Company's nearest pole in the highway to the location where said service is desired, and shall furnish and own a pole line conforming to the Company's specifications on the said route, including pole or poles, suitable for the support of a transformer and its appurtenances and for the attachment of the wires and insulators and shall deliver to the Company a written permit from all interested parties, granting to the Company the right and privilege of erecting and maintaining on said pole line the necessary wires and insulators to properly furnish said service.

(2) The Company shall furnish at its expense all the wire and insulators necessary to run the said service connection, and these shall be and remain the property of the Company, and when the service over said line shall cease, the Company shall be permitted to enter and repossess itself of the materials so furnished.

(3) The Company will maintain and replace when necessary the entire extension, including the poles.

(4) The Customer further requests the Company to furnish and erect the pole or poles as set forth in paragraph (1) above and it is agreed between the parties hereto that

the Company shall furnish and construct said pole line which will require the setting of ———— poles in consideration for which the Customer agrees to pay to the Company $———.

In witness whereof the parties hereto have set their hands the day and year first above written.

The Detroit Edison Company, by —— ——, Special Agent. —— ——, (Customer.)

———

[fol. 41] Instructions

1. For definition of *Service Connections* and rules concerning same see extracts from the Company's rule concerning *Line Extensions* and *Service Connections*, as filed with the Michigan Public Utilities Commission reprinted on the back hereof.

2. This agreement for Private Property Service Connection is applicable to any overhead line construction on the premises of a Customer or on his private right of way whether the same be entirely an extension of a low tension (or secondary) service connection or whether it be an extension of a high tension primary circuit to a transformer suitably located on the Customer's premises with secondary service connections beyond the transformer to the entrance switch. The agreement is not applicable to service connections which carry high tension or primary current for delivery to the customer in that form.

3. Copy of this agreement is to be given to the Customer.

— Exhibit V (Reverse)

Extracts from the Company's Rule Concerning Line Extensions and Service Connections

(Reprinted from Rule 5 Fourth Revised Sheet 8 and 8A Filed with Michigan Public Utilities Commission)

Service Connections

Overhead Low Tension Service Connections: The Company will make at its own expense from its overhead lines, low tension overhead service connections requiring only a single span swung from the pole line on the abutting high-

way to the premises. When a service connection cannot be swung by a single span the Company will furnish the wire and insulators for the extension but the customer shall *pay for and own such pole or poles as may be necessary to erect on his property.* The Company will, however, maintain and replace when necessary the entire extension, *including the poles.*

Line Extensions and Service Connections: Where a farm line has been erected on private property separated by the highway from the premises to be served and at a distance too great for a single span service connection, the Company will provide at its own cost the poles needed to bring the service connection to the property line, including the first pole needed to be set on the premises. Poles on the premises other than the first pole must be paid for by the customer.

Underground Low Tension Service Connections: The Company will make at its own expense from its underground lines low tension underground service connections from its conduit to the property line. That part of an unde-ground service connection which may extend on the Customer's property beyond the property line is at the customer's expense.

In lieu of the standard overhead connection the customer may elect to provide an underground service connection to [fol. 42] the Company's overhead pole line entirely at his expense and the Company will connect the extension to its line through a suitable pothead, the cost of the pothead and its connection to the underground service being paid by the customer and the cost of connection of the pothead to the overhead line being borne by the Company.

High Tension Service Connections: Overhead Service Connections for the delivery of primary (high tension) current will be made entirely at the expense of the customer.

Within the corporate limits of any city or village such service connections may be made underground, at the option of the Company, if it shall appear that an overhead service connection would be or become unsafe to the public. In such case, the Company will bring its conduit up to the property line at its expense and the customer shall pay for that part of the conduit within his premises and for all of the service cable.

BEFORE UNITED STATES BOARD OF TAX APPEALS

THE DETROIT EDISON COMPANY, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 103379. Promulgated October 14, 1941

In some instances the petitioner extends its lines to outlying districts, receiving from the parties desiring the extensions deposits to cover the estimated costs thereof. The petitioner claims the deduction from gross income of the years 1936 and 1937 of depreciation upon the cost of the extensions paid for by its customers. Held, that the petitioner is not entitled to any depreciation allowance in respect of extensions paid for by its customers.

Edward H. Green, Esq., and Harvey A. Fischer, Esq., for the petitioner.

Paul A. Sebastian, Esq., for the respondent.

OPINION

SMITH:

This proceeding is for the redetermination of deficiencies in income tax for the years 1936 and 1937 in the amounts [fol. 43] of $4,031.04 and $6,267.94, respectively. The single issue raised is whether the respondent erred in disallowing deductions for depreciation in the respective amounts of $40,273.11 and $41,786.26 for the taxable years.

All of the facts material to the issue are covered in a signed stipulation of facts which we adopt as our findings of fact.

The petitioner is a corporation, organized and existing under and by virtue of the laws of the State of New York, but duly admitted and licensed to do business in the State of Michigan. It filed its income tax return for 1936 and 1937 with the collector at Detroit, Michigan.

The petitioner is a public utility corporation engaged, among other things, in the generation and sale of electric energy in the city of Detroit, Michigan, and surrounding territory, and operates under the jurisdiction of the Michigan Public Service Commission.

Petitioner, in connection with the distribution and sale of electric energy, from time to time receives applications for the extension of its transmission or distribution lines

to places which in the opinion of the petitioner are situated too far from existing transmission or distribution lines to warrant the expenditure of amounts necessary to make such extensions.

Upon payment by the applicant of a sum fixed by the petitioner, the lafter agrees in writing to make the necessary expenditures for the construction of the desired line extension. The agreement between the petitioner and each applicant is evidenced by one of five types of agreements, copies of which are made a part of the stipulated facts.

The petitioner has from time to time required the applicant to pay varying sums ranging from $500 per mile to $1,500 per mile of line extension. These amounts as fixed by the contracts represent the estimated cost per mile of line construction.

The amount of the payment made by the applicant is the estimated cost, and not the actual cost, but it never [fol. 44] exceeds the actual cost of constructing the requested line extension, and no increase or decrease is made in the amount fixed in the contract upon the completion of the line extension by reason of the actual cost thereof. The amount paid by the applicant is in all cases final as to such applicant. The applicant may, however, in accordance with the agreement in writing providing for refunds, become entitled to receive all or part of such payment upon the happening of the events provided for therein.

The material and property used in the construction of the line extension and the cost of labor is in all cases paid from the general working funds of the petitioner. The records of the petitioner set forth and identify all work performed and to be performed under the provisions of any given contract.

Upon the completion of the line extension, the petitioner, in accordance with standard practice, enters upon its books as a "property item" (such as poles, lines, etc.) the cost of the line extension, including labor and material, and does not subtract from that sum the amount of the payment made by the applicant.

Depreciation is claimed by the petitioner for income tax purposes for the years 1936 and 1937 upon the cost to the petitioner thus arrived at, at rates approved by the Commissioner.

The cash payment made by the applicant in those contracts providing for refunds is not earmarked for the build-

ing of any given line extension, but upon its receipt becomes a part of the free working capital of the petitioner. The cash account is debited with the full amount of the payment and a like amount is credited to a liability account entitled "Customers' Deposits for Line Extension", classified under account No. 261, "Miscellaneous Unadjusted Credits", as required by the Uniform Classification of Accounts for Electric Utilities prescribed by the Michigan Public Service Commission. After the expiration of the period during which refunds may be made to the customers under the [fol. 45] terms of the written contract pursuant to which line extensions have been constructed, petitioner is then required by account No. 255 to transfer the unrefunded balance, if any, from account No. 261, "Miscellaneous Unadjusted Credits", to account No. 255, "Contributions for Extensions." With respect to those contracts which do not provide for refunds, the cash payments are debited to cash and credited to account No. "255—Contributions for Extensions."

At the expiration of the five-year period during which refunds may be made to depositors, the petitioner credits to surplus the amount of the unrefunded balance with respect to each agreement expiring during the taxable year. During the years 1936 and 1937 the petition thus credited to surplus $36,065.81 and $47,500.67. In its income tax returns for 1936 and 1937 petitioner did not report in taxable income the above amounts credited to surplus. The respondent did not in the determination of the deficiencies subject such sums to Federal income tax.

In lieu thereof the respondent held that the petitioner was not entitled to deduct depreciation upon such part of the cost of line extensions covered by the agreements as was presented by the unrefunded balances of deposits. The unrefunded balances of the deposits at the close of each of the years 1935, 1936, and 1937 were as follows:

1935	$1,148,679.86
1936	1,184,745.67
1937	1,232,246.34

In the determination of the deficiencies the respondent has disallowed a depreciation deduction upon the mean of those balances between the beginning and close of each of the years 1936 and 1937. These media were for $1,166,-

712.77 for 1936 and $1,208,496.01 for 1937. The depreciation disallowed for 1936 and 1937 was $40,273.11 and $41,786.26, respectively.

In its income tax returns for 1936 and 1937 the petitioner claimed a depreciation allowance upon the total cost of its depreciable properties, including the full amount [fol. 46] of the cost of line extensions, a part of which was paid for by its customers. In the determination of the deficiencies the respondent has disallowed depreciation upon such portion of the cost of its depreciable properties as was represented by the unrefunded balances of deposits referred to above.

The respondent's argument is that the petitioner is not entitled to a depreciation allowance except upon the cost of depreciable properties borne by it. He admits that under the principle of Edwards v. Cuba Railroad Co., 268 U. S. 628; Liberty Light & Power Co., 4 B. T. A. 155; Great Northern Railway Co., 8 B. T. A. 225; Frank Holton & Co., 10 B. T. A. 1317; and Baltimore & Ohio Railroad Co., 30 B. T. A. 194, the petitioner is not taxable upon the gain realized by it from the unrefunded deposits credited to surplus in 1936 and 1937 of $36,065.81 and $47,500.67, respectively. He contends, however, that if the petitioner is entitled to deduct depreciation upon the cost of extensions borne by its customers it obtains a double benefit, which is not warranted by the statute.

We think that the contention of the respondent upon this point must be sustained. In United States v. Ludey, 274 U. S. 295, the Supreme Court said:

> • • • The amount of the allowance for depreciation is the sum which should be set aside for the taxable year, in order that, at the end of the useful life of the plant in the business, the aggregate of the sums set aside will (with the salvage value) suffice to provide an amount equal to the **original cost.** The theory underlying this allowance for depreciation is that by using up the plant a gradual sale is made of it. The depreciation charged is the measure of the **cost** of the part which has been sold. • • • (Emphasis supplied.)

It is fundamental that the depreciation deduction is allowed upon a capital investment. Where a taxpayer has no capital investment in property it is not entitled to a

depreciation allowance in respect of the capital asset. The essential requirements of a capital investment are the laying [fol. 47] out of money or money's worth and the acquisition of something of permanent use or value in the business. La Belle Iron Works v. United States, 256 U. S. 377. The mere ownership of property which cost the owner nothing does not give rise to the right of a depreciation allowance.

Petitioner, in effect, claims that we must treat the deposits as mere contributions to its capital, and that the building and ownership of the lines must be treated as a separate transaction. The petitioner's argument is that the statute does not permit us to "trace the funds" with which the power lines were built and that the mere facts that the lines are owned by the company, are used in its business, and have a limited useful life require us to sustain its position. The difficulty with this argument is that it overlooks the very substance of the transactions involved. The contracts can not be broken down as suggested, for they are in essence contract the very purpose of which is to permit the company to avoid the cost of constructing new lines. If we were to sustain the petitioner's argument it would be to permit the petitioner to recover through depreciation allowances the cost of line extensions which was not borne by itself. The respondent's determination of deficiencies is approved.

Decision will be entered for the respondent.

45 B.T.A.

BEFORE UNITED STATES BOARD OF TAX APPEALS

DECISION—Entered October 14, 1941

Pursuant to the determination of the Board, as set forth in its opinion promulgated October 14, 1941, it is

Ordered and Decided: That there are deficiencies in income tax for the years 1936 and 1937 in the respective amounts of $4,031.04 and $6,267.94.

(Signed) R. R. Arundell, Member.

[fol. 48] BEFORE UNITED STATES BOARD OF TAX APPEALS

PETITION OF THE DETROIT EDISON COMPANY FOR REVIEW BY THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT OF A DECISION BY THE UNITED STATES BOARD OF TAX APPEALS—Filed January 10, 1942

To the Honorable Judges of the United States Circuit Court of Appeals for the Sixth Circuit:

The Detroit Edison Company, the petitioner in this cause, by Edward H. Green, Harvey A. Fischer and Oscar C. Hull, counsels, hereby files its petition for a review by the United States Circuit Court of Appeals for the Sixth Circuit of the decision by the United States Board of Tax Appeals rendered October 14, 1941, 45 B. T. A., No. 64, and entered on the same day determining deficiencies in the petitioner's Federal income tax for the years 1936 and 1937, in the respective amounts of $4,031.04 and $6,267.94, and respectfully shows:

1. The party seeking this review is The Detroit Edison Company. The petitioner, The Detroit Edison Company is a corporation duly organized and existing under and by virtue of the laws of the State of New York, with its principal office for the transaction of its corporate business at 2000 Second Avenue, Detroit, Michigan.

2. The taxable periods involved are the calendar years 1936 and 1937.

3. The petitioner filed its Federal income tax return for each of the years 1936 and 1937 in the office of the Collector of Internal Revenue for the Michigan District, which office is, and was at the time said return was filed, located at Detroit, Michigan, within the Sixth Circuit.

4. The respondent herein is the Commissioner of Internal Revenue, Washington, D. C., and said respondent appeared in the United States Board of Tax Appeals by J. P. Wenchel, Chief Counsel of the Bureau of Internal Revenue, Washington, D. C.

Wherefore, the petitioner prays that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Sixth Circuit, that a transcript of the record be prepared in accordance with law

[fol. 49] and with the rules of said Court and transmitted to the Clerk of said Court for filing, and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said Court.

Edward H. Green, Attorney for Petitioner. Business Address: No. 48 Wall Street, New York, New York.

Oscar C. Hull, Attorney for Petitioner. Business Address: 1101-14 Dime Building, Detroit, Michigan.

Harvey A. Fischer, Attorney for Petitioner. Business Address: 1101-14 Dime Building, Detroit, Michigan.

(Duly verified.)

BEFORE UNITED STATES BOARD OF TAX APPEALS

STATEMENT OF POINTS TO BE RELIED ON—Filed January 10, 1942

The Detroit Edison Company, being aggrieved by the findings of fact and conclusions of law contained in the opinion of the Board, and by its decision entered pursuant thereto, hereby states that the points on which it intends to rely in this appeal are as follows:

1. The Board of Tax Appeals erred in holding that petitioner's depreciation basis for the calendar year 1936 should be reduced in the amount of $1,166,712.77 representing payments made by customers to petitioner on applications for certain line extensions.

2. The Board of Tax Appeals erred in holding that petitioner's depreciation deduction should be reduced for the calendar year 1936 by the amount of $40,273.11, represent- [fol. 50] ing the application of the petitioner's rate of depreciation on line extensions to said sum of $1,166,712.77.

3. The Board of Tax Appeals erred in holding that petitioner's depreciation basis for the calendar year 1937 should be reduced in the amount of $1,208,496.01 representing payments by customers to petitioner on applications for certain line extensions.

4. The Board of Tax Appeals erred in holding that petitioner's depreciation deduction should be reduced for the calendar year 1937 by the amount of $41,786.26, repre-

senting the application of the petitioner's rate of depreciation on line extensions to said sum of $1,208,496.01.

5. The Board of Tax Appeals erred in failing to find that petitioner was entitled to a depreciation deduction for the calendar year 1936 in the amount of $40,273.11 greater than the amount of depreciation allowed by the Commissioner.

6. The Board of Tax Appeals erred in failing to find that petitioner was entitled to a depreciation deduction for the calendar year 1937 in the amount of $41,786.26 greater than the amount of depreciation allowed by the Commissioner.

7. The Board of Tax Appeals erred in holding that the petitioner's basis for the purpose of computing depreciation on certain line extensions should be reduced on account of certain payments made by certain customers served by such line extensions.

8. The Board of Tax Appeals erred in directing the entry of judgment for the respondent for deficiencies in income tax for the years 1936 and 1937 in the respective amounts of $4,031.04 and $6,267.94, and in not finding for petitioners that there was no deficiency in income tax for said years.

Edward H. Green, Attorney for Petitioner. Oscar C. Hull, Attorney for Petitioner. Harvey A. Fischer, Attorney for Petitioner.

[fol. 51] BEFORE UNITED STATES BOARD OF TAX APPEALS

NOTICE OF FILING PETITION FOR REVIEW AND STATEMENT OF POINTS—Filed January 13, 1942

You are hereby notified that The Detroit Edison Company did, on the 10th day of January, 1942, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Sixth Circuit, of the decision of the Board heretofore rendered in the above entitled case. Copies of the petition for review and the

statement of points as filed are hereto attached and served upon you.

Dated this 12th day of January, 1942.

(S.) B. D. Gamble, Clerk, U. S. Board of Tax Appeals.

Service of copy of Petition for Review and Statement of Points acknowledged this 12th day of January, 1942.

J. P. Wenchel, Attorney for Respondent.

BEFORE UNITED STATES BOARD OF TAX APPEALS

COUNTER-DESIGNATION OF CONTENTS OF RECORD ON APPEAL—Filed January 22, 1942

To the Clerk of the United States Board of Tax Appeals:

Please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Sixth Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause, in connection with the petition for review by the said Circuit Court of Appeals for the Sixth Circuit heretofore filed by the petitioner herein:

1. Docket entries of the proceedings before the Board.

2. Pleadings before the Board,

[fol. 52] (a) Petition, including annexed copy of deficiency letter with attached exhibits, dated the 26th day of April, 1940.

(b) Answer.

3. Stipulation of facts, including exhibits, entered into between the attorneys for the plaintiff in this action on the one side and the Chief Counsel for the Bureau of Internal Revenue on the other.

4. Opinion of the Board of Tax Appeals.

5. Decision of the Board of Tax Appeals.

6. Petition for review, together with proof of service of notice of filing petition for review and of service of one copy of petition for review.

7. This counter-designation of the contents of record on appeal.

J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue.

Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 53] In United States Circuit Court of Appeals for the Sixth Circuit

Cause Argued and Submitted—October 15, 1942

Before Hicks, Hamilton and Martin, JJ.

This cause is argued by Norris Darrell and Harvey A. Fischer for Petitioner and by Arthur Manella for Respondent and is submitted to the court.

In United States Circuit Court of Appeals

Judgment—Entered November 30, 1942

Appeal from the United States Board of Tax Appeals

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, It is now here ordered, adjudged and decreed by this Court that the order or decree of the said Board of Tax Appeals in this cause be and the same is hereby affirmed.

[fol. 54] In United States Circuit Court of Appeals

Opinion—Filed November 30, 1942

Before Hicks, Hamilton and Martin, Circuit Judges

Hamilton, Circuit Judge:

This is a proceeding for a review of a decision of the United States Board of Tax Appeals to redetermine a deficiency in petitioner's income and excess profits taxes for

the years 1936 and 1937 in the respective amounts of $4,031.04 and $6,267.94. A single issue is presented, viz., what sum, if any, petitioner is entitled to deduct from gross income on account of depreciation of a capital asset, the cost of which was contributed by prospective users of its electric lines.

The petitioner is a public utility corporation of New York, licensed to do business in Michigan, and is engaged in generating and selling electric energy in the city of Detroit and surrounding territory and operates under the jurisdiction of the Michigan Public Service Commission.

Petitioner, in connection with the distribution and sale of electric energy, from time to time receives applications for extension of its transmission or distribution lines to places which, in petitioner's opinion, are situated too far from its existing lines to warrant the expenditure of the amounts necessary to make such extensions. In such cases petitioner, prior to the construction of the desired extension, requires the applicant to pay to it a sum representing the estimated cost per mile for construction of such extension, which is agreed to in writing.

The record shows four types of agreements: (I) The customer shall pay to the petitioner in cash the estimated cost of constructing the line and procurement of the right-of-way. At the end of each calendar year, beginning with the end of the year of construction and for four years thereafter, petitioner agrees to refund to the customer or his assignee an amount equal to one-half of petitioner's revenue from the line, the aggregate refund not to exceed the amount contributed by the customer.

[fol. 55] (II) The customer in no event is entitled to recover any part of his contribution.

(III) The customer is entitled to a refund of $60.00 for each additional customer not named in the contract connected with the original extension after its completion, provided however, that no refund shall be made after the close of the fifth calendar year following that year during which the extension was built, nor shall the total refund in any event be in excess of the sum originally contributed by the customer.

(IV) The customer is required to provide a feasible and reasonable route for the extension of the service

connection from petitioner's nearest pole in the highway to the location where said service is desired and shall furnish the necessary poles to support a transformer and its appurtenances and for the attachment of the wires and insulators and the customer shall deliver to petitioner a written permit from all interested parties granting the petitioner the right of erecting and maintaining on said pole line the wire and insulators necessary to properly furnish the service. The petitioner is to furnish at its expense all wires and insulators necessary to operate said service connection which shall be and remain its property and when service over the line ceases, petitioner shall be entitled to repossess all the materials so furnished but shall maintain and replace the entire extension including the poles so long as the service is in operation. If the petitioner furnishes and constructs the pole line, the customer shall pay the cost thereof and the customer recovers no part of his contribution.

The material and labor used in the construction of the line extensions under the foregoing contracts were paid from the general working funds of the petitioner and it made in its books of accounts entries identifying all work performed under the provisions of each respective contract.

Upon the completion of the line extensions, petitioner in accordance with its regular system of accounting entered upon its books as a property item the cost thereof. It made [fol. 56], no book reduction in the cost of construction on account of the sums it had theretofore received from prospective customers. The cash payments received from applicants under contracts providing for contingent refunds were not earmarked in petitioner's accounts for the building of line extensions, but the sums received were carried into petitioner's accounts of free working capital. Petitioner's cash account was debited for the amount of the payments and credited to a liability account entitled "Customers Deposits for Line Extensions" and further classified as "Miscellaneous Unadjusted Credits." This method of accounting was in accordance with the accounting regulations of the Michigan Public Service Commission.

At the expiration of the period of refundment to customers, the petitioner transferred the unrefunded balances from "Miscellaneous Unadjusted Credits" to an account designated "Contributions for Extensions." There was also included in this account sums received from customers

who were not entitled to refunds. On its books petitioner debited these sums to cash and credited them to "Contributions for Extensions." When the period expired for refundments to contributing customers, all remaining balances in the accounts were credited to surplus. During the years 1936 and 1937, petitioner's surplus was increased from this source $36,065.81 and $47,500.67 respectively. Neither of these items was included in petitioner's gross income. The Board found that petitioner's capital sum recoverable through depreciation allowance, with the exception of refunds, did not include the cost of construction of extensions where its prospective customers had contributed to petitioner a sum equal to the cost thereof. It accordingly reduced petitioner's capital sum for the purposes of depreciation the mean of the unrefunded balances of customers' deposits between the beginning and close of each of the years 1936 and 1937. These media for the years 1936 and 1937 were $1,166,712.27 and $1,208,496.01 respectively. The net result was the disallowance of $40,273.11 depreciation deduction for the year 1936 and $41,[fol. 57] 786.27 for the year 1937. These disallowances which petitioner seeks to have reinstated in these proceedings resulted in the deficiency in taxes.

Section 23(l) of the Revenue Act of 1936, c. 690, 48 Stat. 648 [Internal Revenue Code, 26 U. S. C. A., Sec. 23(l)] authorizes, as a deduction from gross income, a reasonable allowance for depreciation of property used in the trade or business of a taxpayer. Section 23(n) of the same Act [Internal Revenue Code, 26 U. S. C. A., Sec. 23(n)] fixes the basis for depreciation as provided in Section 114. Section 114 [Internal Revenue Code, 26 U. S. C. A., Section 114(a)] provides that the basis for depreciation shall be the adjusted basis provided in Section 113(b) for the purpose of determining the gain or loss upon the sale or other disposition of such property.

Section 113(b) of the Act [Internal Revenue Code, 26 U. S. C. A., Section 113(b)] provides the adjusted basis for determining the gain or loss from the sale or other disposition of property shall be the basis determined under Subsection (A) and further adjusted as provided under 113(b)(1)(a) which provides for adding or deducting from the 113(a) basis expenditures, receipts, losses or other items properly chargeable to capital account.

Section 113(a) [Internal Revenue Code, 113(a)] provides that the basis for determining gain or loss shall be (a) cost (a)(2) if acquired by gift after December 31, 1920, the same as it would be in the hands of the donor.

Section 113(8) (B) [Internal Revenue Code, 113(8)(B)] provides that property acquired by a corporation as paid-in surplus or as a contribution to capital, for the purpose of determining the basis of loss or gain, shall be the same as it would be in the hands of the transferor.

Depreciation deduction from taxable net income is a very familiar provision of the income tax statute but many complex factors enter into its determination. Like all other deductions, the allowance is a matter of legislative grace. The purpose of the Statute is to create a fund to restore the property to the extent of the investment of [fol. 58] the taxpayer at the end of its useful life. Basic to the allowance of depreciation is the determination of the capital sum to which the annual rate is to be applied. As will be noted from the enumerated sections of the Revenue Act on the subject, so far as the basic sum is to be determined, the sections of the statute authorizing the allowance are concatenated with the sections of the statute providing for the adjusted basis for the determination of gain or loss on the sale of capital assets.

The ultimate answer to the problem we have here is what would have been the basis for determining gain or loss had petitioner sold the assets in question. The cost of property to a taxpayer is the basis to be used in determining gain or loss from the sale or other disposition thereof, increased or decreased according to certain receipts, expenditures or losses chargeable to capital account.

When determining the cost of a depreciable asset not acquired by a purchase or exchange, but as we have here, from an aggregation of expenditures incurred in its creation, the expenditures, receipts, losses or other items, as the case may be, must be properly chargeable to the capital account which represents the depreciable property. All expenditures having some reasonable relationship to the asset are a part of its cost and likewise all receipts having some reasonable relationship to the asset, must be deducted from the cost.

The contributions made by the prospective users of petitioner's facilities had a direct relationship to the

cost thereof and, in determining petitioner's cost, such contributions must be deducted under the express provisions of Section 113(b)(1)(a) of the Act. Petitioner had no capital investment in the depreciable property here in question. *Southern Power & Mfg. Company* v. *Commissioner*, 82 F. (2d) 104 (C. C. A. 5); *Kell, et al.* v. *Commissioner*, 88 F. (2d) 453 (C. C. A. 5).

As the facts appear in the record, the refunds which petitioner had contracted to make to its customers who had contributed the cost of the erection of the facilities were too indefinite in amount and time of payment to be [fol. 59] capitalized as representative of their cost to the petitioner at the time such depreciable assets were constructed. There could then be no reasonable prediction as to the amount petitioner would ultimately refund. It is essential to the creation of an accruable liability or reserve that there be an agreement between the parties fixing the amount or that the amount due be determinable with reasonable certainty from the surrounding facts and circumstances. When the obligation is contingent, or indefinite as to amount, its accrual or payment is so uncertain that no charge can be made under any correct system of accounting. *United States* v. *Anderson*, 269 U. S. 422, 441; *Weiss* v. *Wiener*, 279 U. S. 333, 336; *Brown* v. *Helvering*, 291 U. S. 193, 205.

Section 113(a)(2) of the Act has no application to the facts in the case at bar. The contributions petitioner received under the contracts in question were neither gifts nor gratuities but were supported by considerations. *Louisville & Nashville Railroad Company* v. *United States*, 267 U. S. 395, 402; *Edwards* v. *Cuba Railroad Company*, 268 U. S. 628, 632.

A gift is a voluntary transfer of property by one to another without any consideration or compensation therefor. Under the contracts which were the source of the funds used to construct petitioner's improvements, it obligated itself to build the facilities and the contributors expected to obtain full remuneration by the use of the electric energy produced by petitioner.

Section 113(8)(B) of the Act is inapplicable to the case at bar. The phrase "paid-in surplus" is a term commonly employed in corporate financing and accounting, to designate an account on corporate books. The surplus account

represents the net assets of a corporation in excess of all liabilities, including its capital stock and such fund is available for distribution to the corporation's stockholders. None of the funds contributed by petitioner's customers under the contracts in question could have been used for the payment of dividends to petitioner's stockholders. They were for the express purpose of constructing improvements.

[fol. 60] The phrase "contribution to capital" as used in the Revenue Act is a term which as ordinarily understood when applied to private corporations means the fund or property contributed or agreed to be contributed by the share owners as the financial basis for the prosecution of the business of the corporation, such contributions being made either directly through stock subscriptions or indirectly through the transfer of property in exchange for a stock interest in the corporation. As thus used, the term signifies those resources whose dedication to the users of the corporation is made the foundation for the issuance of capital stock and which, as the result of the dedication, become irrevocably devoted to the satisfaction of all the obligations of the corporation. This conclusion is made clear when it is noted that Section 113(8) is in conjunction with the sections of the Act providing for transfers to corporations in connection with a reorganization. If petitioner had diverted the funds thus obtained to another purpose and had abandoned the project, the donors could have reclaimed their contributions. It is clear the contributions could not have been legally devoted to the satisfaction of all the obligations of the petitioner.

The Board reached the conclusion that the petitioner was entitled to include in its capital expenditures for depreciable assets, a sum equal to the amounts it had refunded to contributing customers in each year, over the useful life of the depreciable assets. Under the state of the record we are not called on to decide whether the refunds which petitioner made were capital expenditures having a reasonable relationship to the cost of a depreciable asset, or were ordinary and necessary business expenses. There is an essential difference between capital expenditures and deductions from gross income for ordinary and necessary expenses in carrying on a trade or business. Capital is a fund from which income flows or expenses arise. Since the Commissioner and the Board included in petitioner's de-

preciable capital account for each year the refunds made to petitioner's customers out of gross receipts, we are not [fol. 61] permitted to disturb that allowance even if it were incorrect. *Helvering* v. *Pfeiffer*, 302 U. S. 247, 251.

The conclusion here reached is in conflict with the case of *Arundel-Brooks Concrete Corporation* v. *Commissioner of Internal Revenue*, 129 F. (2d) 762 (C. C. A. 4), which is strongly relied on by petitioner. In our opinion the court in that case fell into error in not giving due weight to the concept that the elements of the taxing act in question do not stand independent and isolated from each other. They all combine to produce a specific rule for the determination of deductible depreciation. The word "cost" as used in Section 113(a) beyond question refers to the cost of the property to the taxpayer. This is made manifest when Section 113(a) is considered in the light of Subsection (2) which provides for a different base if the property is acquired by gift and also Subsection (8) (B) which provides for a different basis if property is acquired by a corporation as "paid-in surplus or as a contribution to capital."

The court in the cited case assumed that the word "cost" as used in the statute related to the property and was not confined to the cost of the property to the taxpayer. The case of *Nashville Warehouse & Elevator Corporation* v. *Commissioner*, 105 F. (2d) 883 (C. C. A. 6), also relied on by petitioner, is clearly distinguishable on its facts from the case at bar.

As we view it, neither the provisions of the Act in question nor the interpretative regulations may be read fairly to authorize the deductions claimed by petitioner.

Order of the Board is affirmed.

[fol. 62] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 63] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1942

No. 675

[Title omitted]

ORDER ALLOWING CERTIORARI—Filed March 1, 1943

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Sixth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

The Chief Justice took no part in the consideration or decision of this application.